

Office of the State Auditor
Division of State Audit

North Dakota Racing
Commission
Bismarck, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 670

Robert R. Peterson
State Auditor



LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE MEMBERS

Representative Bob Skarphol – Chairman
Senator Randel Christmann – Vice Chairman

Representatives

Ole Aarsvold
Larry Bellew
Merle Boucher
Kari L. Conrad
Jeff Delzer
Bette Grande
Patrick R. Hatlestad
RaeAnn G. Kelsch
Kenton Onstad
Louis Pinkerton
Blair Thoreson
Francis J. Wald

Senators

Dwight Cook
Jerry Klein
Judy Lee
Harvey D. Tallackson

You may obtain reports by contacting the
Division of State Audit
at the following address:

Office of the State Auditor
600 East Boulevard Avenue – Department 117
Bismarck, ND 58505-0060
(701) 328-2241

Reports are also available on the internet at:
www.nd.gov/auditor/

Contents

<i>Transmittal Letter</i>	<i>1</i>
<i>Executive Summary</i>	<i>2</i>
<i>Introduction</i>	<i>2</i>
<i>Responses to LAFRC Audit Questions</i>	<i>2</i>
<i>LAFRC Audit Communications</i>	<i>3</i>
<i>Audit Objectives, Scope, And Methodology</i>	<i>5</i>
<i>Discussion And Analysis</i>	<i>7</i>
<i>Financial Summary</i>	<i>7</i>
<i>Financial Statements</i>	<i>9</i>
<i>Statement of Revenues and Expenditures</i>	<i>9</i>
<i>Statement of Appropriations</i>	<i>10</i>
<i>Internal Control</i>	<i>11</i>
<i>Administrator's Account for Breeders' Awards</i>	<i>12</i>
<i>Tax Collection on Simulcast Wagers</i>	<i>13</i>
<i>Code of Ethics/Code of Business Conduct/Fraud Assessment</i>	<i>15</i>
<i>Compliance With Legislative Intent</i>	<i>17</i>
<i>Noncompliance with Contract Award Requirements</i>	<i>18</i>
<i>Use of Breeders' Funds for Purse Supplements</i>	<i>19</i>
<i>Operations</i>	<i>21</i>
<i>Continuance of Declining Fund Balance</i>	<i>21</i>
<i>Breeders' Registry Contract</i>	<i>23</i>
<i>Management Letter (Informal Recommendations)</i>	<i>24</i>

Transmittal Letter

March 26, 2008

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Randy Blaseg, Director of Racing

We are pleased to submit this audit of the North Dakota Racing Commission for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Dan Cox, CPA, was the staff auditor. Paul Welk, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2320. We wish to express our appreciation to Director Blaseg and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Racing Commission is the regulatory body in charge of regulating live and simulcast racing in North Dakota and administers three special funds for the benefit of the horse racing industry in North Dakota. The Commission is made up of five members appointed by the Governor and the office staff consists of a Director of Racing and Administrative Staff Officer.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the North Dakota Racing Commission in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Other than our findings addressing "noncompliance with contract award requirements" (page 18) and "use of breeders' fund for purse supplements" (page 19), the North Dakota Racing Commission was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "administrator's account for breeders' awards" (page 12), "tax collection on simulcast wagers" (page 13), and "code of ethics/code of business conduct/fraud assessment" (page 15), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

Other than our work addressing "continuance of declining fund balance" (page 21), and "breeders' registry contract" (page 23), there were no indications of lack of efficiency in financial operations and management of the North Dakota Racing Commission.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

The North Dakota Racing Commission has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 24 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The North Dakota Racing Commission's financial statements do not include any significant accounting estimates.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance and Human Resource Management System (HRMS) are high-risk information technology systems critical to the North Dakota Racing Commission.

Audit Objectives, Scope, And Methodology

Audit Objectives

The objectives of this audit of the North Dakota Racing Commission for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Racing Commission's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Racing Commission and are they in compliance with these laws?
3. Are there areas of the North Dakota Racing Commission's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the North Dakota Racing Commission is for the biennium ended June 30, 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The North Dakota Racing Commission's sole location is its central office which will be included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls are operating effectively and to determine if laws are being followed consistently. Nonstatistical sampling was used and the results were projected to the population.

Further, where applicable, populations are stratified to ensure that particular groups within a population are adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) ERP system. Given the complexity of the state's accounting system significant evidence was obtained from ConnectND.
- Observed North Dakota Racing Commission's processes and procedures.

In aggregate there were not any significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Discussion And Analysis

The accompanying financial statements have been prepared to present the North Dakota Racing Commission's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2007, operations of the North Dakota Racing Commission were primarily supported by tax revenue collected on pari-mutuel wagering. This is supplemented by appropriations from the state's general fund.

FINANCIAL SUMMARY

Revenues consisted primarily of racing tax revenue, as well as interest and license fees. Total revenues were \$397,294 for the year ended June 30, 2007 as compared to \$736,192 for the year ended June 30, 2006.

Racing tax revenue decreased from \$600,644 for the year ended June 30, 2006 to \$250,116 for the year ended June 30, 2007. The decrease is due to the drop in the tax rates to each of the three North Dakota Racing Commission funds (breeders fund, purse fund, promotions fund). On the first \$11,000,000 of wagering handle the North Dakota Racing Commission receives .5% for each of their three funds. After the \$11,000,000 amount is reached, the North Dakota Racing Commission receives .0625%. Since the \$11,000,000 cap resets each biennium, the first \$11,000,000 wagered in the year ended June 30, 2006 was taxed at the higher rate, causing the fluctuation in revenue.

The total wagering handle for the year ended June 30, 2006 was \$57,758,750 as compared to \$75,585,764 for the year ended June 30, 2007. The \$11,000,000 cap was reached in September 2005. For the current biennium, the \$11,000,000 cap was reached on March 9, 2008.

Total expenditures for the North Dakota Racing Commission were \$1,732,637 for the year ended June 30, 2007 as compared to \$566,630 for the prior year. The increase in total expenditures for the audited period reflects primarily a timing difference as to when the grants to the two North Dakota horse tracks were made – grants for the 2006 racing season were made in July 2006 and grants for the 2007 racing season were made in June 2007.

Payments to the Fargo and Belcourt horse parks, Breeders Fund award payments, and salaries represent over 90% of the total expenditures of the North Dakota Racing Commission.

In the February 11, 2008 meeting minutes, the Racing Commission authorized payments of \$630,000 for the 2008 racing season for the Belcourt and Fargo tracks.

The increase in Salaries and Benefits reflects the director of racing job being vacant from the start of the biennium until Randy Blaseg was hired effective January 1, 2006. All other expenditures remained fairly constant.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

	<u>June 30, 2007</u>	<u>June 30, 2006</u>
<u>Revenues and Other Sources:</u>		
Racing Taxes	\$250,116	\$600,644
Interest	83,813	84,189
Registration Fees/Licenses	28,903	25,280
Unclaimed Winning Tickets and Reimbursement for Simulcast Auditor	34,462	15,349
Revenue from Prior Biennium		10,730
Total Revenues and Other Sources	<u>\$397,294</u>	<u>\$736,192</u>
<u>Expenditures and Other Uses:</u>		
Grants to Tracks	\$1,376,182	\$215,750
Breeders Award Payments	165,951	209,500
Salaries and Benefits	128,185	87,561
Professional Services	24,620	19,041
Travel	13,732	11,178
Rent of Building Space	7,826	
Dues/Conference Registration	6,190	3,865
Other Expenses	9,951	19,735
Total Expenditures and Other Uses	<u>\$1,732,637</u>	<u>\$566,630</u>

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Racing Commission	\$ 367,145		\$ 367,145	\$ 319,238	\$ 47,907
Totals	<u>\$ 367,145</u>	<u>\$ 0</u>	<u>\$ 367,145</u>	<u>\$ 319,238</u>	<u>\$ 47,907</u>
Expenditures by Source:					
General Fund	\$ 117,479		\$ 117,479	\$ 117,476	\$ 3
Other Funds	249,666		249,666	201,762	47,904
Totals	<u>\$ 367,145</u>	<u>\$ 0</u>	<u>\$ 367,145</u>	<u>\$ 319,238</u>	<u>\$ 47,907</u>

Expenditures Without Appropriations Of Specific Amounts:

The Breeders' Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$615,462 of expenditures for this biennium).

The Purse Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$505,000 of expenditures for this biennium).

The Racing Promotion Fund has a continuing appropriation authorized by NDCC section 53-06.2-11 (\$859,566 of expenditures for this biennium).

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the North Dakota Racing Commission's internal control as being the highest risk:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of the North Dakota Racing Commission in a management letter dated March 26, 2008.

ADMINISTRATOR'S ACCOUNT FOR BREEDERS' AWARDS

We noted a lack of segregation of duties surrounding the administrator's account used to make breeders' awards payments and pay administrative costs. We also noted that money deposited into this account (at a local bank) exceeded the amount required for the Breeders' awards payments and yearly administrative costs, and at times exceeded the \$100,000 amount covered by the Federal Deposit Insurance Corporation (FDIC).

Currently the fund administrator's (an independent contractor) duties include: receiving, endorsing, and depositing the annual check received from the North Dakota Racing Commission into a local bank account; calculation of the check amount for each eligible horseman; writing and signing (dual endorsement) approximately 75 checks for the award payments and administrative costs each year; and reconciling the bank statement to the book balance. Internal controls would be improved by having the fund administrator calculate the breeders' award amounts and providing that information to the Racing Commission for payment through the state's accounting system. This would reduce the likelihood of errors or irregularities.

We noted the balance in the administrator's account had grown to approximately \$49,000 in September 2007, after all the 2006 breeders' award checks had been cashed. The account balance is accruing due to the amount allocated for administrative costs exceeding the actual costs. We also noted that at times the account balance exceeded the FDIC coverage of \$100,000 until enough checks cleared to drop the balance below that amount. Also, as the fund administrator is not a state employee, he is not bonded through the Insurance Department.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Racing Commission have the fund administrator calculate the breeders' award payments and provide that information to the Racing Commission for payment through the state's accounting system.

We also recommend the local bank account (administrator's account) be closed and the remaining balance be returned to the breeders' fund at the Bank of North Dakota.

North Dakota Racing Commission Response:

The Racing Commission agrees with this finding.

The independent auditor has and will continue to calculate the breeders' award payment as previously been done. However

further research is required to determine the efficiency and cost effectiveness of making the individual payments through the PeopleSoft system.

The request for the independent auditor to close the local bank account (the Breeders' Administrative Fund which was established in the mid 1996) and transfer the balance to the Breeders' Fund will be presented to the Commission at a future meeting for their consideration.

Finding 07-2

TAX COLLECTION ON SIMULCAST WAGERS

Procedures need to be improved to ensure that the state is receiving the proper amount from simulcast wagers.

There are two simulcast providers in North Dakota: Lien Games and Premier Turf Club (starting February 2007). The Racing Commission has contracted with a local accountant to be their simulcast auditor. His duty is to track the handle (wagers placed in ND) from the simulcast provider sites, verify that data, and compile it in both monthly and annual reports to the Racing Commission. The handle is tracked based on information received from the simulcast providers. This data is then verified by comparing it to reports generated from the AmTote (licensed tote company) system. However, we noted per discussion with the simulcast auditor, the reports with the AmTote information are not received directly from AmTote, but are routed through the two simulcast providers.

A monthly report for each provider is prepared by the simulcast auditor for the Racing Commission, noting the amounts wagered for various types of bets and how much will be received in state tax dollars plus contributions to the Commission's purse, breeders, and promotion funds.

Per North Dakota Century Code section 53-06.2-11, the amount of taxes and special fund contributions changes once a certain threshold or cap is reached. During our testing of this law we noted the July, August, and September of 2005 AmTote reports could not be located.

When reviewing the monthly simulcast auditor reports received by the Racing Commission, it was noted that the March 2007 report for Lien Games wasn't received until June 2007 while the Premier Turf Club report wasn't received until October 2007. For the October 2007 reports, one was received in December 2007 while the other one was received in January 2008. As of April 2008, the January 2008 report had yet to be received. The recap report is based on the calendar year, only received annually, and has no

year-to-date totals. This makes it difficult to use the report for managerial purposes such as budgeting and monitoring the wager caps when the tax law changes.

Recommendation:

We recommend:

- The North Dakota Racing Commission ensure reports for AmTote handle information be received by the simulcast auditor directly from AmTote, rather than routed through the simulcast provider where they could be changed.
- The simulcast auditor maintain all supporting documentation.
- The North Dakota Racing Commission require monthly simulcast auditor reports be received in a timely manner.
- The recap report be received monthly, be prepared on a fiscal year basis, and include a column for year-to-date information.

North Dakota Racing Commission Response:

The Racing Commission agrees.

Both Lien Games and Premier Turf Club provide the simulcast auditor access so he can retrieve the AmTote data independent of them. This provides the auditor with the proper information to complete a proper audit. The Racing Commission demands that the simulcast auditor use AmTote reports retrieved independent of the Service Providers when completing his audit.

The Director of Racing implemented additional procedures independent of the simulcast auditor. The licensed tote (Amtote) notifies the Racing Commission office just a few days after the end of each month alerting the commission as to the total amount wagered through each service provider. This office then compares that figure with the reported amount and they should be equal. As director I felt this verification by the Racing Commission was necessary and the Director of Gaming agreed. This is our in house method of checks and balances and all the proper taxes have been paid.

It is definitely the responsibility of the simulcast auditor to properly maintain support documentation. The simulcast auditor shall comply.

The Commission feels that the simulcast audits should be completed prior to the monthly report provided by the service providers which includes payment of taxes.

In a discussion with the simulcast auditor the director was informed that this method of late reporting has been the norm and has been carried out in a similar fashion when reporting to the three previous directors. In reviewing the 2005 season when Mr. Meyer was director the February 2005 simulcast audit was not submitted to the Racing Commission until August 31st and the March 2005 simulcast audit was not submitted until September 6th.

The new contract signed by the simulcast auditor does require submission of reports in a timely manner. The simulcast auditor shall be required to be in compliance with the new contract.

The recap report would be easier to work with off of a fiscal year report rather than a calendar year. The Racing Commission is currently receiving the reports monthly and will require all reports have a column for year-to-date information.

Auditor Clarification

As noted in paragraph two of their response, the Racing Commission states the simulcast auditor has direct access to AmTote reports and they demand he use those reports. However, this is not the current procedure.

Finding 07-3

CODE OF ETHICS/CODE OF BUSINESS CONDUCT/FRAUD ASSESSMENT

The North Dakota Racing Commission has not completed a fraud risk assessment and does not have a Code of Ethics or a Code of Business Conduct. The Committee of Sponsoring Organizations' Internal Control – Integrated Framework identifies these as important elements of adequate internal control.

Periodic fraud risk assessments are necessary to identify potential areas of fraud to help ensure adequate controls are put into place. A proper Code of Ethics or Code of Business Conduct helps establish a sound control environment. This will help communicate to employees what behaviors are expected and what behaviors will not be tolerated and the consequences of not complying with these important policies.

The North Dakota Racing Commission was unaware of these requirements.

Recommendation:

We recommend the North Dakota Racing Commission perform periodic fraud risk assessments and properly address significant risks that are identified. In addition, the North Dakota Racing Commission should establish a formal Code of Ethics or a Code of Business Conduct.

North Dakota Racing Commission Response:

The Racing Commission agrees with this finding.

The State Auditors informed the Racing Commission that the Racing Commission along with other state agencies, are being informed that these two new policies are to be completed before the next scheduled audit. The Racing Commission was unaware of these two new requirements until informed by the State Auditors in March 2008.

The Racing Commission will seek assistance from the Office of Management and Budget in completing the Code of Ethics or a Code of Business Conduct and a fraud risk assessment.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested North Dakota Racing Commission's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Included In Our Audit Scope

- Collection and depositing of the proper amounts for taxes on pari-mutuel racing (North Dakota Century Code section 53-06.2-11).
- Allowability of the use of funds from the breeders' fund to supplement purses (North Dakota Century Code section 53-06.2-11, section 6).
- Awarding of contract for administration of the breeders' registry (North Dakota Century Code section 53-06.2-04.1).
- Purpose and authorization from the breeders' fund administrators account (North Dakota Administrative Code section 69.5-01-09-03).
- Limitation of breeders' fund administrative costs (North Dakota Administrative Code section 69.5-01-09-03, section 2).
- Payments for breeders' awards (North Dakota Administrative Code section 69.5-01-09-10).
- Proper use of the following legally restricted funds:
 - Breeders' fund.
 - Purse fund.
 - Promotion fund.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2005 North Dakota Session Laws chapter 3).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards requires auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are

required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These findings are described below. Other than those findings, we concluded there was compliance with the legislative intent identified above. We also noted certain inconsequential instances of noncompliance that we have reported to management of the North Dakota Racing Commission in a management letter dated March 26, 2008.

Finding 07-4

NONCOMPLIANCE WITH CONTRACT AWARD REQUIREMENTS

We are unable to determine if the North Dakota Racing Commission awarded a contract to the lowest responsible bidder in accordance with North Dakota Century Code (NDCC).

House Bill 1324 of the 2007 session created a new section of North Dakota Century Code 53-06.2-04.1, which states: "The commission shall provide for registration of a North Dakota-bred horse for qualification for breeders' fund awards and purse supplements. The commission shall contract with a private person to maintain the registry. Through a competitive bidding process, the commission shall award the contract to the lowest responsible bidder. The cost of the contract must be paid from the breeders' fund."

The Commission used a Request for Proposal process to award the contract. Bid proposals were evaluated and points were awarded for contract cost, experience and qualifications, and understanding of the contract. We noted the Commission received two bid proposals, one for \$11,520 and the other for \$7,200. During their November 19, 2007 commission meeting the North Dakota Racing Commission scored each bid proposal and subsequently awarded the contract to the highest scoring vendor that bid \$11,520.

The scoring process used by the Commission was not appropriate, as the contract was to be awarded to the lowest responsible bidder. The Commission should have used a scoring process that required the award to be made to lowest responsible bidder, and provided justification if any bidders were determined to be not 'responsible.'

Recommendation:

We recommend that the North Dakota Racing Commission comply with North Dakota Century Code section 53-06.2-04.1 and award the contract for the breeders' administrator to the lowest responsible bidder.

North Dakota Racing Commission Response:

We agree that the Racing Commission, in coordination with the Office of Management, State Procurement Office, inadvertently used a procurement method not contemplated in the statute. The Racing Commission worked with the State Procurement Office to develop the solicitation to select the contractor to maintain the Registry. The State Procurement Office used a Request for Proposal process which is the type of solicitation normally used for management services contracts (See N.D.C.C. § 54-44.4-10, N.D.A.C. § 4-12-08-04 and Level 1 Procurement Manual, Section 5.4). The request for proposal process is generally considered best practice when procuring professional services because it enables the agency develop evaluation criteria to determine which proposal or contractor is most advantageous, based upon cost and other factors, such as experience and qualifications.

Action has been taken. The first contract was terminated without cause by the contractor in May 2008. The Racing Commission worked with the OMB State Procurement Office to develop an Invitation for Bid to award a contract for North Dakota Breeders' Fund Administration services to the lowest, responsible bidder. The Invitation to Bid was issued on June 4, 2008, and bids are due on July 2, 2008.

Finding 07-5

USE OF BREEDERS' FUNDS FOR PURSE SUPPLEMENTS

We are unable to determine if the North Dakota Racing Commission is in compliance with North Dakota Century Code section 53-06.2-11 regarding the use of breeders' funds for purse supplements.

House Bill 1324 of the 2007 session amended North Dakota Century Code 53-06.2-11, section 6, which references the breeders' fund, purse fund, and racing promotion fund and states that the commission may not transfer money among the funds.

According to one of the sponsors of House Bill 1324, it was their intent that this amendment prevents the North Dakota Racing Commission from using funds from the breeders' fund for any purses.

The North Dakota Racing Commission's legal counsel from the Attorney General's Office has interpreted the law as not having any effect on the use of breeders funds for purse supplements as they have never 'transferred' money between funds.

The North Dakota Racing Commission does use funds from the breeders' fund to supplement purses for races at the two North Dakota tracks. Races that receive this purse supplement are exclusively for North Dakota bred horses, which are also eligible for breeders' award payments. Per review of the February 11, 2008 North Dakota Racing meeting minutes, they approved payments of \$125,000 for the 2008 racing season from the breeders' fund for purse supplements.

We reviewed bill testimony and feel it is unclear if this law would forbid the use of breeders' fund dollars to be used for purse supplements as is currently the case.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Racing Commission seek a formal Attorney General's opinion to determine if their current practice is in compliance with the state law.

North Dakota Racing Commission Response:

The Racing Commission agrees that an opinion from the Attorney General for the use of Breed Fund money to supplement purses for certified North Dakota Bred races is a wise move to resolve this issue. This opinion was requested March 30th.

Operations

Our audit of the North Dakota Racing Commission identified the following areas of potential improvements to operations, as expressed by our operational objectives:

- Are the North Dakota Racing Commissions current operations sustainable? The criteria used for this operational improvement will be the North Dakota Racing Commission's revenues, expenses, and the resulting trend of its fund balances.
- Could the North Dakota Racing Commission improve the Breeders' registry contract administration? The criteria used to address this operational improvement will be the timeliness of the execution of the audit contract.

Operational Improvement 07-1

CONTINUANCE OF DECLINING FUND BALANCE

We noted certain areas of concern in regards to the continued declining fund balance in the three funds run by the North Dakota Racing Commission.

Background:

Based on review of the year-end fund balance amounts for the three North Dakota Racing Commission funds (breeders', purse, and promotion), the continued decline in the fund balance presents future concerns regarding the ability of the North Dakota Racing Commission to continue functional operations – including payments to tracks and breeders.

Per our review of the February 11, 2008 meeting minutes, the North Dakota Racing Commission has authorized payments of \$630,000 for the 2008 racing season for the Belcourt and Fargo tracks (\$125,000 breeders' fund, \$305,000 purse fund, and \$200,000 promotion fund).

While the scheduled 2008 disbursements appear to be a decrease in what has been allocated in prior years, it is still apparent that the future of these funds is in jeopardy.

Of the \$330,971 of income for the three funds in calendar year 2007, \$72,538 (22%) is interest income, which will continue to decrease based on declining fund balances. Out of the total 2007 calendar year expenditures of \$1,669,801, we also noted \$123,171 of salaries for Racing Commission employees.

If the fund balance decline continues, it appears the North Dakota Racing Commission will be able to continue its current funding

pattern through the 2009 racing season before the funds will be substantially depleted and drastic cuts will be necessary.

The following table shows the balances for the North Dakota Racing Commissions fund as of calendar year end.

Breeders Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 2,369,555	\$ 1,939,451	\$ 1,676,001	\$ 1,327,612
Income	30,136	135,352	77,612	82,016
Expenses	(460,240)	(398,802)	(426,001)	(666,844)
Ending Fund Balance	<u>\$ 1,939,451</u>	<u>\$ 1,676,001</u>	<u>\$ 1,327,612</u>	<u>\$ 742,784</u>
Purse Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 2,415,584	\$ 2,010,078	\$ 1,746,488	\$ 1,355,275
Income	30,705	137,030	80,288	84,389
Expenses	(436,211)	(400,620)	(471,501)	(522,054)
Ending Fund Balance	<u>\$ 2,010,078</u>	<u>\$ 1,746,488</u>	<u>\$ 1,355,275</u>	<u>\$ 917,610</u>
Promotion Fund	2004	2005	2006	2007
Beginning Fund Balance	\$ 1,943,744	\$ 1,420,890	\$ 1,144,174	\$ 873,268
Income	80,170	243,165	188,788	164,566
Expenses	(603,024)	(519,881)	(459,694)	(480,903)
Ending Fund Balance	<u>\$ 1,420,890</u>	<u>\$ 1,144,174</u>	<u>\$ 873,268</u>	<u>\$ 556,931</u>
Total Fund Balances	<u>\$ 5,370,419</u>	<u>\$ 4,566,663</u>	<u>\$ 3,556,155</u>	<u>\$ 2,217,325</u>

Operational Improvement:

We recommend the North Dakota Racing Commission implement a plan that allows for sustained future operations. This plan should not be based on any assumption of future increased revenue – either through increased pari-mutuel betting through simulcast or account wagering sites or increased gambling opportunities presented at the Horse Park.

North Dakota Racing Commission Response:

The racing commission agrees.

The commissioner would like to see that racing industry leaders formulate legislation for the financial growth of the racing industry. At the current time the Commission is working with Horsemen's Council seeking their recommendations

BREEDERS' REGISTRY CONTRACT

We noted the length of time for the North Dakota Racing Commission to set up the contract for the Breeders' Registry seemed excessive.

Background:

House Bill 1324, which was signed by the Governor on March 21, 2007, required the commission to contract with a private person to maintain the registry of North Dakota-bred horses for qualification for breeders' fund awards or purse supplements.

The one-year contract with a private person to maintain the registry was signed on December 4, 2007, which was more than eight months after the house bill became law.

We also noted during April 2008, the vendor terminated their contract with the North Dakota Racing Commission.

Operational Improvement:

We recommend the North Dakota Racing Commission ensure they minimize the time necessary to award future contracts.

North Dakota Racing Commission Response:

We agree. Action has been taken. The Racing Commission worked with the Office of Management and Budget, State Procurement Office to issue an Invitation for Bid for North Dakota Breeders' Fund Administration Services that will open on July 2, 2008. The contract will run through June 15, 2009 with annual renewal options. Thus future solicitations will be conducted in approximately April-May and awarded in June. This schedule will enable the contractor to be sufficiently prepared for the heavy workload and required disbursement of Breed Fund awards in December.

Moreover, the initial contract allowed either party to terminate the contract without cause upon 30 days notice, which proved to be insufficient. The new contract requires a 90 day termination notice, which would enable the Racing Commission to select a new contractor prior to the contract being terminated without cause.

Management Letter (Informal Recommendations)

March 26, 2008

Mr. Randy Blaseg
Director of Racing
North Dakota Racing Commission
500 N. 9th Street
Bismarck ND 58501-4509

Dear Mr. Blaseg:

We have performed an audit of the North Dakota Racing Commission for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Racing Commission's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status as non-reportable conditions.

The following present our informal recommendations.

CASH

Informal Recommendation 07-1: We recommend the North Dakota Racing Commission implement an independent reconciliation of receipts to deposits.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 07-2: We recommend the North Dakota Racing Commission ensure support for all correcting entries is maintained and approved.

LEGISLATIVE INTENT

Informal Recommendation 07-3: We recommend the North Dakota Racing Commission comply with Administrative Code 69.5-01-09-10, which states checks shall void if not cashed within 60 days of issuance and funds shall revert back to the breeders' fund for future distribution.

Informal Recommendation 07-4: We recommend the North Dakota Racing Commission comply with the procurement requirement that all service contracts over \$2,500 contain the required bid documentation.

Informal Recommendation 07-5: We recommend the North Dakota Racing Commission require contracts for all applicable services – specifically including the breeders' fund auditor.

Management of North Dakota Racing Commission agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

Kevin Scherbenske
Auditor in-charge